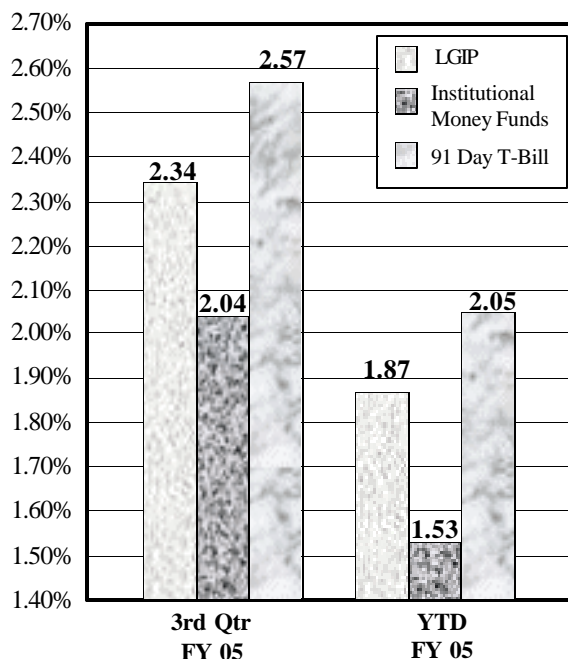




**COMMONWEALTH OF VIRGINIA**  
**Department of the Treasury**  
**Jody M. Wagner, State Treasurer**  
P. O. Box 1879  
Richmond, Virginia 23218  
Toll-Free (800) 643-7800  
Phone (804) 225-3166  
Fax (804) 225-3478

## Participant Newsletter March 31, 2005

### Yield Comparison



### Investment Guidelines Compliance (03-31-05):

	<u>Actual</u>	<u>Max.</u>
•Diversification:		
U. S. Treasury/Agency	35.1%	100%
Repurchase Agreements	22.5%	50%
Negotiable CDs & BAs	10.3%	40%
Non-Negotiable CDs	0.3%	25%
Commercial Paper	17.5%	35%
Corporate & Bank Notes	14.3%	25%
•Maturity Limitations:		
Average Days to Maturity		63 days
Average Maturity May Not Exceed		90 days

### Monthly Statistics:

•Avg NAV: \$2,330,042,000	•Active Accounts: 899
•Simple Yield: 2.50%	•Effective Yield: 2.53%

### Quarterly Performance:

	<u>3rd Qtr</u>	<u>YTD</u>
	<u>FY 05</u>	<u>FY 05</u>
•Average Yield:		
LGIP	2.34%	1.87%
Institutional Money Funds*	2.04%	1.53%
91 Day T-Bill	2.57%	2.05%

\*Consist of 673 institutional money market funds totaling \$851.5 billion as reported by IBC/Donoghue as of 03-31-2005.

### News of Interest:

On March 22 the Federal Open Market Committee (FOMC) increased the federal funds target to 2.75%. This was the seventh increase since the tightening cycle began on June 30, 2004. After seven rate increases the Fed still believes “the stance of monetary policy remains accommodative” and “policy accommodation can be removed at a pace that is likely to be measured.” Further tightening is expected throughout the year with economists forecasting year-end fed funds in the neighborhood of 3.50% to 3.75%.

Several changes to the statement language have put the markets on an increased inflation alert. The FOMC acknowledged, “pressures on inflation have picked up in recent months and pricing power is more evident.” They added a statement to the balance of risks section “with appropriate monetary policy action,” which seems to indicate they will continue to raise rates as long as inflationary pressures remain. The Fed, also, characterized output growth as “solid” rather than “moderate,” implying that it believes that current economic growth has more staying power. Markets initially reacted negatively to the statement with some economists predicting at least one 50 basis point move by the June 30 meeting. Economic data released since the meeting has given some relief from inflation fears and the markets have settled down. It is now anticipated that the Fed will only increase rates 25 basis points at its May 3 meeting. The minutes for the March 22 meeting will be released on April 12, which will provide additional color on the heightened focus on inflation.

Many economists felt the Fed did not change its risk assessment from balanced as an implicit acknowledgement of remaining downside risks to the economy, particularly in light of ongoing energy cost increases. Energy concerns have recently moved front and center with the issues now twofold. First is the concern about global supply and demand of oil, which has been at issue for almost two years. Second, this is the time of year when gasoline supplies become the major concern, and any refinery outages or disruptions will drive prices higher very quickly. Currently, oil at the refinery stage is a very overheated system that is running flat out. When there is a shortage or a disruption, there is no one who can offset the loss. High oil prices affect everyone, but many people are not affected as directly or as quickly by high oil prices as they are by high gasoline prices. It appears there is a new concern that high gasoline prices this summer could have a more negative impact on the overall economy than has been experienced in the recent past. Also, it did not help the overall market tone that a Goldman Sachs analyst predicted that oil could reach \$105 a barrel should a major disruption occur.

The March employment report was a big disappointment as non-farm payrolls increased only 110,000, less than half of the forecasted number. Payrolls have, on average, increased 178,000 per month over the past year and 174,000 per month over the past six months, indicating that payroll growth has been and most likely will continue to be moderate, at best. The unemployment rate fell to 5.2% from 5.4% in February.

Other March reports were mixed. The Institute for Supply Management's (ISM) manufacturing index was 55.2 versus the previous month's report of 55.3, and the non-manufacturing ISM index rose to 63.1 from 59.8, signaling that activity outside of manufacturing remains strong. The Conference Board's consumer confidence index fell to 102.4, the second small monthly downturn. Given the rise in energy prices, this report is actually better than anticipated. Results suggest that production-side momentum persists, but continued higher energy costs should reduce the growth in consumer spending in coming months.

March retail sales will be released in several days; however, a review of February retail sales and inflation reports provides possible support for the FOMC's new position. Retail sales rose 0.5% in February, following a 0.3% gain in January and a 1.3% gain in December. Ex-autos, the results were similar, a 0.4% gain in December, 1.0% in January, followed by a 0.4% gain in February.

With the focus now on inflation, market participants are anxious to see if the recent surge in commodity prices may get passed along to the consumer more readily than in recent years. Both PPI and CPI have been trending upwards. The February's overall PPI for finished goods rose 0.4% versus a 0.3% increase in January, bringing the year over year increase to 4.7%. Excluding food and energy, the increase was 0.1%, following January's 0.8% increase. Core PPI has increased 2.8% during the past year. The CPI for February continued to show an upward drift in consumer inflation. The overall CPI rose 0.4% and the core rose 0.3%, both higher than the previous month's reports. During the past year CPI inflation is up 2.9% and the core CPI has increased 2.3%, causing Fed officials more concern and unnerving bond market participants.

For the past several years the yield on short-term investments such as the LGIP has suffered as the Fed lowered rates to historically low levels. Now with short-term yields rapidly rising, short duration portfolios are quickly adjusting. Currently forecasters indicate short-term rates will continue their upward climb through 2006. The forward markets are pricing year-end fed funds at approximately 4.00%, which is a little higher than economic forecasters. The Fed's transparency has permitted an orderly transition from accommodation to tightening throughout the past year. For the most part, yields have reflected assumed breakeven analysis, but we are always looking for opportunities to lock in longer yields that we perceive add value relative to breakeven assumptions. We look forward to serving you, and want to hear your thoughts and ideas.